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No. 81-2361

IN THE

Supreme Court of the United States

October Term, 1981

STANLEY M. GROSSMAN,

Petitioner,

v.

FIDELITY MUNICIPAL BOND FUND, INC. and FIDELITY MANAGEMENT and RESEARCH CO.,

Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

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POINT I

The Court of Appeals Decision Conflicts with this Court's Decision in *Burks* v. *Lasker*

The principal argument advanced by the respondents is that the Court of Appeals decision does not conflict with this Court's decision in *Burks* v. *Lasker,* 441 U.S. 471 (1979), because *Burks* dealt with directorial termination of suit whereas the Court of Appeals decision dealt with the necessity for demand upon directors.

The argument misses the point. In *Burks* this court correctly stated that, by enacting § 36(b), Congress prevented board action from cutting off derivative suits; *id.* at 484. The cutting off of derivative suits applies equally to a decision not to sue before litigation is commenced as well as a decision to terminate an action already commenced. Indeed, this Court noted in *Burks* that a directorial decision not to sue—

in situations not covered by § 36(b)—is consistent with allowing the independent directors to terminate suit; *id.* at 485.

The purported rationale enunciated by the Court of Appeals for requiring a pre-complaint demand is that it can serve the function of informing the court of the directors' knowledgeable viewpoint on the merits of the litigation; 674 F.2d at 121. Certainly, the views of the directors should be considered on the merits; § 36(b)(2) so directs. But it is neither necessary nor appropriate to invoke Rule 23.1 to apprise the court of their attitude.*

Three other circuits—the Second, Fifth and Ninth Circuits—have held that Congressional creation of an action which can be instituted by any security holder, as under § 36(b), obviates the requirements of Rule 23.1 so that suit may be brought by a shareholder "without qualification"; *Blau* v. *Mission Corp.*, 212 F.2d 77, 79 (2d Cir. 1954), *cert. denied*, 347 U.S. 1016 (1954); and "not subject to the procedural requirements of the Rule [23.1]"; *Dottenheim* v. *Murchison*, 227 F.2d 737, 740 (5th Cir. 1955), *cert. denied*, 351 U.S. 919; *Pellegrino* v. *Nesbit*, 203 F.2d 463, 466 (9th Cir. 1953).

The aforesaid cases all dealt with § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). In *Burks* this Court analogized the inability of the directors to cut off a derivative suit brought under § 36(b) to the right of a shareholder to sue under § 16(b) of the Exchange Act "notwithstanding the decision of the board of directors not to sue." 441 U.S. at 484 n. 13. Thus, the conflict of the decision of the Court of Appeals in the instant case with this Court's decision in *Burks* v. *Lasker*—as well as with the decisions of the Second, Fifth and Ninth Circuits cited above—could not be more direct.

* Moreover, in the instant case, the post-complaint demand served to advise the court of the directors' position to the same extent that a pre-complaint demand would have done.

POINT II

The Court of Appeals Decision Conflicts With This Court's Holdings in Implied Right of Action Cases

The statute creates an express right of action by the Securities and Exchange Commission and by any security holder of an investment company. "In view of these elaborate enforcement provisions it cannot be assumed that Congress intended to authorize by implication additional judicial remedies". *Middlesex County Sewerage Authority* v. *National Sea Clammers Association*, 101 S.Ct. 2615, 2623 (1981). Nevertheless, respondents seek to imply such a right of action on behalf of the Fund from those provisions of the Investment Company Act designed to bolster the role of independent directors (Resp. Br., p. 11).

To be sure, Congress in the 1970 amendments to the Investment Company Act included provisions imposing stringent duties upon disinterested directors, as well as interested directors, of investment companies. And Congress believed that this would strengthen the role of disinterested directors. But there is no inconsistency between those provisions and the provisions enabling security holders to sue directly. Indeed, they are complementary means for remedying the evil which Congress was attempting to eliminate: namely, the charging of excessive advisory fees by investment advisors:

> "The unaffiliated directors, as the only potentially disinterested persons in the management of most investment companies, can and should play an active role in representing the interests of shareholders not only in connection with management compensation but in other areas where the interests of the professional managers may not coincide with those of the company and its public investors. Strengthening the voice of truly disinterested directors in investment company affairs is important to

the protection of public shareholders. *But even a requirement that all of the directors of an externally managed investment company be persons unaffiliated with the company's adviser-underwriter would not be an effective check on advisory fees and other forms of management compensation.*" (House Rep. No. 2337, 89th Cong., 2d Session, p. 148 (1966)). (emphasis supplied)

In order to provide such a check, Congress authorized suits by the SEC and by security holders, but not by investment company directors. As the court noted in *Boyko* v. *The Reserve Fund, Inc.*, 68 F.R.D. 692, 695 (S.D.N.Y. 1975), the decision not to confer the right to sue upon the corporation was not an oversight. It resulted from reluctance to vest control of advisory fee litigation in the directors, who were deemed to be ineffective checks upon management compensation. Since they can not sue, no demand upon them is required.

CONCLUSION

For the foregoing reasons the petition for writ of certiorari should be granted.

Respectfully submitted,

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